BEFORE THE HEARING OFFICER
OF THE TAXATION AND REVENUE DEPARTMENT
OF THE STATE OF NEW MEXICO

IN THE MATTER OF THE PROTEST OF
FRANCIS & STARZYNSKI, P.A., No. 95-07
I.D. NO. 02-138376-00 6, PROTEST
TO ASSESSMENT NO. 1753028.

DECISION AND ORDER

This matter came on for hearing on July 10, 1995 before Gerald B. Richardson, Hearing Officer. Francis & Starzynski, P.A. (hereinafter "Taxpayer") was represented by Douglas T. Francis, Esq., President. The Taxation and Revenue Department (hereinafter "Department") was represented by Bruce J. Fort Special Assistant Attorney General.

Based upon the evidence and the arguments presented, it is hereby DECIDED AND ORDERED as follows:

FINDINGS OF FACT

1. The Taxpayer is a law firm which has been in operation in New Mexico since January, 1990.

2. As the result of an audit of the Taxpayer by the Department, on February 5, 1994 the Department issued Assessment No. 1753028 to the Taxpayer assessing $6,275.96 in gross receipts tax, $627.60 in penalty and $1,681.66 in interest for the reporting period of January 1, 1990 through June 30, 1993.

3. On February 11, 1994, the Taxpayer filed a timely, written protest with the Department protesting Assessment No. 1753028.

4. The only discrepancy in how the Taxpayer handled the reporting of gross receipts tax noted by the Department's auditors concerned the Taxpayer's treatment of expenses which it incurred and which were reimbursed to the Taxpayer by the Taxpayer's clients. The Taxpayer did not treat the reimbursed expenses as gross receipts subject to tax.

5. Prior to the formal hearing in this matter the Taxpayer and the Department agreed upon the tax treatment of various categories of reimbursed expenses. It was agreed that the reimbursement of court reporter fees, expert witness fees and fees for research performed by third parties were not subject to gross receipts tax. It was further agreed that the reimbursement of costs for faxes, federal express, travel expenditures and long distance telephone charges were receipts subject to gross receipts tax.

6. The only issue remaining to be resolved is whether the charges which the Taxpayer incurs on behalf of clients for photo copying performed by an independent third party and which costs are reimbursed to the Taxpayer by its clients are receipts subject to the gross receipts tax.

7. The Taxpayer does not own its own copying machine. Instead, it has its copying performed by PC Services, which has an office the building in which the Taxpayer's office is located and also in the Bankruptcy Court, where the Taxpayer performs a substantial portion of its law practice.

8. When the Taxpayer needs copies made, the documents to be copied are delivered to PC Services with a notation of either a client's last name, if the copying is being done for a specific client, or "office" if the copying is not going to be charged to a specific client.

9. PC Services bills the Taxpayer for its copying charges on a monthly basis. The monthly bill contains a breakdown between the copies charged to "office" and those earmarked by client last name. PC Services charges the Taxpayer gross receipts tax on the total charges for copying.

10. Under the terms of the "Attorney-Client Agreement" entered into between the Taxpayer and its clients the "Client agrees to pay all out-of-pocket costs of Attorneys [the Taxpayer] (including . . . photocopy costs . . ., etc.) spent by Attorneys in the representation of Client. . . ."

11. When the Taxpayer bills the client for photocopying costs pursuant to the Attorney-Client Agreement, the Taxpayer only bills for its actual costs and adds not mark up to the actual costs incurred. Additionally, the Taxpayer does not charge the client for gross receipts tax upon the amount it charges the client for photocopying costs.

12. In determining its billing policy not to charge gross receipts tax upon photocopying charges, Mr. Francis, who is an attorney, determined that such charges should not be subject to gross receipts tax on the basis that these charges are incurred as agents of the client and were subject to tax when the services were purchased from PC Services. In making this determination, Mr. Francis did not consider regulation GR 3(F):75 which addresses the taxability of reimbursed costs.

DISCUSSION

The primary issue to be determined is whether the Taxpayer is subject to gross receipts tax for its receipts from reimbursed photocopying costs. If that issue is resolved in favor of the Department, then the issues of the Taxpayer's liability for penalty and interest also must be determined.

There is no statutory exclusion in the Gross Receipts and Compensating Tax Act, Chapter 7, Article 9, NMSA 1978 for money received as reimbursement for business expenses. However, the courts, over the years have interpreted the Act to exclude from gross receipts amounts received as a trustee or agent. *See,* ***Westland Corp. v. Commissioner of Revenue****,* 83 N.M. 29, 33, 487 P.2d 1099, 1103 (Ct. App.), ***cert. denied***, 83 N.M. 22, 487 P.2d 1092 (1971), and more recently, ***Carlsberg Management Co. v. New Mexico Taxation and Revenue Department****,* 116 N.M. 247, 861 P.2d 288 (Ct. App. 1993). In 1988, the Department adopted regulation GR 3(F):75 which recognizes the common law agency exception where the reimbursement of the expenditure represents the reimbursement of an expense incurred as an agent on behalf of a principal. It is upon this basis that the Taxpayer claims it is not subject to gross receipts tax.

The issue of determining when a taxpayer's reimbursed expenses qualify for the agency exception to the imposition of tax is a difficult one which has been the subject of extensive discussion by our courts in recent years. The ***Carlsberg*** case involved a determination of whether a property management company which managed apartments in a federally subsidized rent program on behalf of the apartment owner was liable for gross receipts tax upon its reimbursements of employment expenses incurred with respect to employees retained to manage and operate the apartments. The rule adopted by the Court of Appeals in its decision is if a party only receives money either as an advance for future payment of or reimbursement for past payment of another's employment-related obligations, then an agency relationship exists sufficient to avoid taxation of those funds as gross receipts. ***Id.*** at 251, 861 P.2d at 292. In that case, the court then went on to examine the contractual agreement between the owner and the taxpayer, looking at the degree of control retained by the apartment owner with respect to the taxpayer's payment of the employee related expenses. Under the facts of that case, the court concluded that the taxpayer was left with no discretion concerning when and how much to pay the employees. The Court also found that the indemnification clause in the agreement between the taxpayer and the owner requiring the owner to pay the Taxpayer for employment expenses indicated that the payment of wages to employees was ultimately the duty of the owner. Based on these considerations, the court concluded that an agency relationship existed and that the taxpayer was not subject to gross receipts taxes upon its reimbursements of employee related expenses.

In the ***Carlsberg*** decision, the Court of Appeals was careful to limit its holding based upon the facts of that case and left for another day its ruling on a "less-pervasive agency relationship." ***Id.*** at 252, 862 P.2d at 293. That day arrived on May 1, 1995 when the Court of Appeals issued its decision in ***Brim Healthcare, Inc. v. State of New Mexico, Taxation and Revenue Department***, Court of Appeals No. 15,658. That case also involved the reimbursement of employee related expenses, but the taxpayer was a business providing hospital management

services and key hospital employees to hospitals in New Mexico. The court concluded in ***Brim***, however, that an agency relationship did not exist under the facts of that case. As in the ***Carlsberg*** case, the court focused on two areas in determining whether an agency relationship existed. It focused on whose obligation was it for which the taxpayer was reimbursed and it looked to the degree of control which the alleged principal had over the alleged agent with respect to the reimbursed costs at issue. In ***Brim,*** the court concluded that there was no broad indemnification clause which had the effect of shifting the obligation from the nominal employer to the purported principal and that the other terms of the agreement established that the employees were the taxpayer's and not the hospital's employees. Thus, the reimbursement of the taxpayer's employee related expenses by the hospital was not a reimbursement of an expense incurred as an agent of the hospital and was subject to gross receipts tax.

Brim and ***Carlsberg*** establish that in determining whether a reimbursed expense was incurred in an agency capacity turns on the analysis of two factors: first, the relationship between the parties must be analyzed to determine whose obligation to pay does the expense represent, and secondly, to what extent does the purported principal retain control over the purported agent with respect to the cost at issue?

With respect to the first issue, the Taxpayer relies upon the fact that the copy company has a client name and thus knows that the copying job is being purchased by the Taxpayer on behalf of its client. The Taxpayer also relies upon Section 36-2-11 NMSA 1978 which establishes an attorney's authority to bind its client to any agreement within the scope of his duties and powers and that an oral statement of such authority is sufficient. The facts as conveyed by the Taxpayer do not establish that the obligation to pay the copying costs truly lies with the client, however. While it is true, the Attorney-Client agreement establishes that the Client is required to reimburse the Attorney for the cost incurred, the obligation at issue is the obligation to pay PC Services. Mr. Francis could not recall any discussion between his firm and PC Services where it was

discussed that the names given were names of clients or that under his Attorney-Client agreements that the clients were obligated to reimburse his firm for the copying costs. Additionally, the only name that PC Services was given was the last name of a client. This would hardly inform PC Services which "Smith" or "Gallegos" could be looked to pay for any copying costs associated with that billing appellation. The reality of the copying transaction is that the Taxpayer's clients do not deal with the copying company and the copying company has no dealings with the client. There is nothing in the record to indicate that the client knows who the copying company is or even that the client is aware that the Taxpayer contracts out its photocopying services. The client's bill only reflects a cost listed as "photocopy expense" which is not broken down by number of copies or cost per copy and makes no reference to the name of any third party provider. This leads us to the second inquiry, the degree of control exercised by the purported principal over the purported agent with respect to the transaction at issue. The only thing in the record pertinent to this issue is that the Attorney-Client agreement requires the client to reimburse the Taxpayer for its photocopy costs. As noted above, there is nothing to indicate that clients are even aware that photocopying is contracted out by the Taxpayer. Additionally, there is nothing to indicate that the number or cost of copies are limited or controlled in any way by the clients. The reality is that the clients are contracting for professional legal services from the Taxpayer and the Taxpayer is rendering professional legal services, which include, such reasonable and necessary photocopying expenses as, in the professional judgment of the Taxpayer, are appropriate to the legal services being rendered. This does not arise to the level of control exercised by the principal which the Court of Appeals found so persuasive in the ***Carlsberg*** case. The Taxpayer in this case is not a mere conduit of funds between the Taxpayer's clients and the copying company where there is no evidence that the clients are even aware of the existence of a third party, and they do not control when the copying company is paid, the cost of the copies, or any of the other terms of the arrangement between the Taxpayer and PC Services.

The Taxpayer also argues that under the standard in New Mexico for determining whether PC Services would be a third-party beneficiary of the Attorney-Client agreement and that this also establishes that a sufficient agency relationship exists to shield the Taxpayer from gross receipts tax on the reimbursement it receives for photocopying. It appears to be undisputed that PC Services would qualify as a third party beneficiary under New Mexico law, but that is not dispositive of the issue of agency. In the ***Carlsberg*** decision the court had this to say with respect to third party liability:

> We are not so much concerned with who is required to pay the employees, as that is but one indicia of agency. We are more concerned with whether Taxpayer had the discretion to pay the employees in a manner other than by the terms of the agency relationship.

Id. at 252, 862 P.2d at 293. Thus, the court was more concerned with the degree of control exercised by the purported principal than by whether third party liability is conclusively established. As noted above, the evidence does not establish the existence of the level of control necessary to establish that a sufficient agency relationship exists with respect to the incurring or payment of photocopying charges.

The Taxpayer has also protested the imposition of interest on the grounds that there has been too long a delay in resolving the matter in protest. Approximately seventeen months elapsed between the date of the assessment and the hearing in this matter. The two operative statutes relevant to this issue are Section 7-1-24 and Section 7-1-67. Section 7-1-67 provides for the imposition of interest and provides in pertinent part:

> If any tax imposed is not paid on or before the day on which it becomes due, **interest shall be paid** to the state on such amount from the first day following the day on which the tax becomes due, without regard to any extension of time or installment agreement, until it is paid . . . . (emphasis added)

Thus, the statute mandates that interest is payable during the time from when the tax was due, until it is paid, with no exceptions which are relevant to the issue herein.

Section 7-1-24(D) governs administrative hearings under the Tax Administration Act and provides that:

> Upon timely receipt of a protest, the department or hearing officer shall promptly set a date for hearing and on that date hear the protest or claim.

The administrative record in this case provides no clues as to what transpired between the Taxpayer and the Department in the months between the tax assessment and the hearing, except that the parties did hold an informal conference at some point prior to the hearing at which some of the issues were resolved between the parties. If the Taxpayer made any efforts to have this matter scheduled sooner, or if the Department failed to respond to any such requests, there was no evidence presented by either party which would provide more of a factual context in which to decide this issue. In any event, there is a case construing Section 7-1-24(D) which governs the determination of this issue. In ***Ranchers-Tufco Limestone Project Joint Venture v. Revenue Division, Taxation and Revenue Department***, 100 N.M 632, 674 P.2d 522, ***cert. denied*** 100 N.M. 505, 672 P.2d 1136 (1983), the taxpayer challenged an approximately two year delay in hearing its protests as violating Section 7-1-24(D). The court noted the ambiguity in the statute, which requires that a ***date*** for a hearing be set promptly, and would require interpretation of the statute to conclude that this required that the hearing itself be held promptly. The court did not resolve this ambiguity. In analyzing this issue, the court assumed, but did not decide that Section 7-1-24 had been violated, but it granted no relief to the taxpayer. Instead, it applied the general rule that tardiness of public officers in the performance of statutory duties is not a defense to an action by the state to enforce a public right or to protect public interests. ***Id.*** 100 N.M. at 635. Since the collection of interest on tax deficiencies is a public right, this rule is applicable to this case as well and the Taxpayer is entitled to no relief from the imposition of interest.

The final issue to be determined is whether penalty may properly be imposed for failing to timely report and pay taxes upon those reimbursed expenses which the Taxpayer has now agreed

are taxable and upon the reimbursed photocopying expenses. Penalty is imposed, pursuant to Section 7-1-69(A) NMSA where the failure to report or timely pay taxes is "due to negligence or disregard of rules and regulations." Regulation TA 69:4 sets forth a number of situations which may indicate that a taxpayer has not been negligent or in disregard of rules and regulations for purposes of the imposition of penalty pursuant to Section 7-1-69(A). Pertinent to our discussion is the fourth situation , which provides in pertinent part:

> the taxpayer proves that the failure to pay tax or to file a return was caused by reasonable reliance on the advice of competent tax counsel or accountant as to the taxpayer's liability after full disclosure of all relevant facts; . . .

In this case, at the time the firm was established and billing practices were determined, Mr. Francis made the determination that the firm's reimbursed expenses were not subject to gross receipts tax. He based his conclusion upon his analysis that these expenses were incurred as agents for the firm's clients and the fact that these costs had already been subjected to gross receipts tax when they were incurred by the firm. Although the Taxpayer has now agreed that not all of the reimbursed expenses would qualify for tax exclusion, this is a complex area and reasonable minds could differ on the tax treatment of these various reimbursed costs. I have no doubt of Mr. Francis' competency to analyze these matters and he certainly had full knowledge of all of the facts relevant to the legal analysis of this issue. Thus, the conditions of Regulation TA 69:4 have been met and the penalty assessed should be abated.

A final matter to be discussed is that at the formal hearing, it was agreed that the Hearing Officer would reserve jurisdiction to determine the amount of gross receipts tax attributable to the photocopying expense issue if it was determined to be taxable. This is because at the time of the hearing, the parties had not yet been able to extract this amount from the amounts attributable to other issues which were agreed upon by the parties. Jurisdiction has been reserved to resolve this issue should the parties be unable to arrive at consensus on this matter.

CONCLUSIONS OF LAW

1. The Taxpayer filed a timely, written protest to the assessment of tax and jurisdiction lies over both the parties and the subject matter of this protest.

2. The Taxpayer did not incur photocopying expenses in the capacity of an agent for its clients and therefore when it received reimbursement of those expenses from its clients, the reimbursements are included in the Taxpayer's gross receipts and are subject to gross receipts tax.

3. The delay in resolving the Taxpayer's protest is not a basis for abating the imposition of interest.

4. The Taxpayer's failure to pay gross receipts tax on its reimbursed expenses was based upon its consultation with its own tax counsel and therefore the Taxpayer was not negligent in failing to pay tax. For this reason the penalty imposed should be abated.

For the foregoing reasons, the Taxpayer's protest to the imposition of tax and interest IS HEREBY DENIED. The Taxpayer's protest to the imposition of penalty IS HEREBY GRANTED. The Department IS HEREBY ORDERED to abate the penalty assessed.

DONE, this 15th day of September, 1995.